No. 3016

United States
Circuit Court of Appeals
FOR THE NINTH CIRCUIT

In the Matter of W. N. RUSSELL, Bankrupt.

THE SCANDINAVIAN AMERICAN BANK, OF BIG TIMBER, MONTANA, a Corporation,

Petitioner,

vs.

JOHN G. ELLINGSON, Trustee for the Bankrupt, W. N. RUSSELL, Doing Business Under the Name of W. N. RUSSELL LUMBER COMPANY, and W. N. RUSSELL, as an Individual,

Respondent,

BRIEF OF RESPONDENT.

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A motion has been interposed to dismiss the petition to review herein upon the following grounds:

1. That the record is not certified to by the Clerk of the United States District Court for the District of Montana as required by Subdivision 1 of Rule 14, of the Rules of the United States Circuit Court of Appeals for the Ninth Circuit.

2. That the transcript of the evidence in the record has not been settled in a bill of exceptions and has not been certified to by the Clerk of the District Court for the District of Montana as a correct copy of the transcript of the evidence on file in the office of the Clerk of the District Court for the District of Montana, and which was reviewed by the Hon. George M. Bourquin, Judge of said Court.

3. That no application has been made to the Circuit Court of Appeals of the Ninth Circuit, or a Judge thereof, for an allowance of the petition for revision herein, and no notice of the serving and filing of such petition has been served herein.

4. That the petition for review herein has not been allowed by the United States Circuit Court of Appeals for the Ninth Circuit, or any Judge thereof.

5. That no citation was issued by the Circuit Court of Appeals herein to the District Court of the United States for the District of Montana, or to the Clerk thereof, to return a true copy of the record in the District Court of the United States for the District of Montana herein, under his hand and the seal of the said Court, or at all, and no such record has been filed herein.

6. That no bond has been filed herein by petitioner.

7. That it appears from the record that the order of the United States District Court for the District of

Montana should be reviewed by appeal under Section 25-a, of the Bankruptcy Act, and not by petition to revise under Section 24-B, of the Bankruptcy Act.

WE WILL TAKE UP THE SEVERAL GROUNDS FOR THE MOTION TO DISMISS IN THE ORDER IN WHICH THEY ARE MADE.

1. There appears to be no rules of the Ninth Circuit Court of Appeals with particular reference to petitions to review under the Bankruptcy Act. General rules, therefore, are applicable.

The petition filed herein is the original petition served on Counsel for the Respondent. It contains certain of the papers used on the hearing before the Referee and before the District Court for the District of Montana, attached to the petition to review as exhibits. It does not even contain the proof of claim of the Scandinavian American Bank, the Petitioner. And the exhibits attached to the petition to review are not even certified to as correct copies of the originals in the office of the Clerk of the United States District Court for the District of Montana.

The Rules of the Circuit Court of Appeals Require:

Rule 14, of the Rules of the United States Circuit Court of Appeals for the Ninth Circuit.

2. The transcipt of the evidence is not settled in a Bill of Exceptions and has not been cetified to by the Clerk of the District Court for the District of Montana as a correct transcript of the evidence.

The evidence used before the Referee and in the District Court is not even made a part of the petition to review filed and served in this case, and the record does not show and the transcript of the evidence was never served upon respondent or its counsel. There is nothing to show

that this transcript of the evidence is a correct copy of the evidence passed upon by the Referee or by the District Court.

Even if we assume that the certificate of the Referee as it appears in the uncertified transcript (Tr. 334) was an original certificate by the Referee, that would be insufficent.

Appeals to the Circuit Court of Appeals are regulated by the Act of Congress of February 13, 1911, Chapter 47.

It requires the transcript to be certified to by the Clerk of the lower Court.

The petition and the requirements upon appeals in bankruptcy cases are substantially the same as in other cases, and the record required to be certified and filed in such cases is the record of the case in the Bankruptcy Court.

> "The District Courts in the several Districts of the United States are by law the Courts of Bankruptcy * * * the Clerk of the District Court being also a Clerk of the Bankruptcy Court can alone, therefore, certify to the Appellate Court the proceedings had in a bankruptcy case, either on appeal or on petition to superintend and revise. He, and he alone, has the authorized seal of the Court."
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> Cook Inlet Coal Fields Co. vs. Caldwell, 17 Am. B. R. 135.
>
> Hegner vs. American Trust & Savings Banks, 26 Am. B. R. 571.
>
> Rule 14, Rules of the United States Circuit Court of Appeals for the Ninth Circuit, subdivisions 1 & 2, 3, 4 and 5. The record does not show that any application was made for the allowance of the petition for revision, or that it was allowed, and it does not show that a citation was issued by the Circuit Court of Appeals to the District Court of the United States for the District of

Montana, or to the Clerk thereof. This certainly is the correct practice under Rule 14 of the Rules of the Circuit Court of Appeals of the Ninth Circuit, subdivisions 1, 2 and 5.

> "The several Circuit Courts of Appeal shall have jurisdiction in equity, either interlocutory or final, to superintend and revise in matter of law the proceedings of the several inferior courts of bankruptcy, within their jurisdiction. Such power shall be exercised on due notice and petition by any party aggrieved."
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> Section 24 of the Bankruptcy Act, Subdivision B.
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> "Appeals from a Court of Bankruptcy to a Circuit Court of Appeals * * * shall be allowed by the Judge of the Court appealed from, or of the Court appealed to, and shall be regulated, except as otherwise provided in the Act, by the rules governing the appeals in equity in the Courts of the United States."
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> Rule 36, General Orders in Bankruptcy.
>
> In re D. Abraham, 93 Fed. 767, 2 Am. B. R. 266.

6. No bond has been filed herein.

Rule 13, Rules of the Circuit Court of Appeals of the Ninth Circuit.

7. The petition in this case is entitled "A Petition for Revision and Review in Section 24-b of the Bankruptcy Act of 1898. (Tr. 1.)

The petition, however, (Tr. 3-4) shows clearly that petitioner seeks not only to "revise in matter of law", but also to review the evidence; and the petitioner alleges that the evidence is insufficient to justify the order of the District Court. It is apparent therefore, that the matter should be reviewed by appeal under Section 25-a of the Bankruptcy Act.

It will probably be contended by petitioner that under the Bankruptcy Act this petition may be treated as a petition to revise under Subdivision B of Section 24 of the

Bankruptcy Act, or as an appeal under subdivision A of Section 25 of the Bankruptcy Act; and that even if the time within which to file the appeal under subdivision A of Section 25 of the Bankruptcy Act has expired, or was not taken in time, they are still entitled to review of the Order under subdivision B of Section 24, of the Bankruptcy Act.

Whatever difference of opinion or divergence of views there may be in the rules of the Circuits as to this question and the construction to be placed upon Sections 24b and 25-a of the Bankruptcy Act, we think that the matter has been determined and set at rest in this Cricuit, and also by the United States Supreme Court.

It is to be borne in mind that the power to superintend and revise under Subdivision B of Section 24 is confined to matters of law, and that the right of appeal under Section 25, subdivision A, reviews both quections of law and fact.

The right of appeal under subdivision A of Section 25 in particular covers three cases: "1. From a judgment adjudging or refusing to adjudge the defendant a bankrupt. 2. From a judgment granting or denying the discharge. 3. From a judgment allowing or rejecting a debt or claim of $500 or over."

1. This appeal is an appeal from the rejection of a claim as a preferred claim and necessarily comes within the third subdivision of the subsection.

In the case of Morehouse vs. Pacific Hardware and Steel Company, reported in 24 Am. B. R. on page 178, 177 Fed. 337, Circuit Judge Gilbert, speaking for the Circuit Court of Appeals of the Ninth Circuit, discussing these two sections of the Bankruptcy Act says:

It is conceivable that the line of demarcation

between "proceedings in bankruptcy" and controversies at law and in equity, arising "in the course of bankruptcy proceedings," may in some cases be obscure; but, generally speaking, the former include all questions arising in the administration of the bankrupt's estate, such as the appointment of receivers and trustees, orders requiring the bankrupt to surrender property of the estate in bankruptcy, orders requiring the bankrupt's voluntary assignee to surrender property of the estate, orders giving proiority to the claim of a creditor, orders directing a set-off of mutual debts, and orders confirming the composition. These are questions which with a view to the prompt administration and distribution of the assets of the bankrupt, the law permits to be summarily disposed of by revision. The latter include all controversies and questions arising between the trustee and adverse claimants of property as property of the estate, whether the property be in his possession or theirs.

Collier on Bankruptcy 10th Edition on page 521 says:

Petitions to revise in matter of law divides with appeals in equity cases the great majority of reviews heard by the circuit court of appeals. The petition differs from such appeals in two important particulars. (1) Petitions to revise bring up questions of law only; appeals both of law and of facts. (2) The former calls up any order or judgment or judicial action in bankruptcy proceedings; the latter three classes of final judgments only. The provisions as to revision in matter of law and appeals were framed and must be construed in view of the distinction between steps in bankruptcy proceedings proper and controversies arising out of the settlement of the estates of bankrupts. In other words, if the question arises in an independent suit to determine a claim necessary for the settlement of the estate, or if it arise in one of the cases specified in Par. 25a, review may be had by appeal; if the question pertain to the bankruptcy proceedings and arise therein review may be had by a petition to revise in matter of law.

The same author on page 522 says:

It has been held that the power to review by appeal conferred by Par. 25a and that to supervise granted by Sec. 25b are cumulative; that the two grants of power are not inconsistent and that in a proper case either may be invoked. There are a number of other cases in which it has been held that where an appeal might be brought under Sec. 25 a review of petition under Sec. 24b was not available. In many of these cases a distinction is made between "proceedings in bankruptcy" under Sec. 24b and "controversies arising in bankruptcy proceedings" which are appealable under the general appealate jurisdiction of the court as conferred by Sec. 24a. Under the principles of these cases if the controversy is one arising in bankruptcy proceedings, review by appeal is exclusive. In view of this conflict of authority it is difficult to declare a rule which will be a safe guide in every case. As has been stated, this contrariety of decision has resulted in such confusion and uncertainty in the practice that lawyers have thought it necessary in many cases to take an appeal and file a petition for revision in the same case in order to be sure to obtain a review of the ruling challenged. The consensus of opinion seems clearly in favor of the principle that if the suit or proceeding is a controversy arising in bankruptcy proceedings it is appealable under Sec. 25a and not reviewable under Par. 24b; the latter refers only to matters in the bankruptcy proceedings itself, that is, any judicial determination, which may be made by a bankruptcy court from the time of the filing of the petition until the estate is closed, pertaining exclusively to the bankruptcy. This distinction is clearly established. As between the power to revise under Sec. 24b and the exercise of appellate jurisdiction under Par. 25a, both of which relate to the review of bankruptcy proceedings, the better rule is that in either of the three cases mentioned in Sec. 25a the review can only be by appeal; but in respect to any other matters in bankruptcy proceedings the review must be by a petition to revise. The Supreme Court has sustained this view by declaring that persons who

are entitled to an appeal under Par. 25a are not entitled to a petition to review under Par. 24b.

The Supreme Court of the United States in the case of Matter of Loving, 224 U. S. 183, 27 Am. B. R. 852, found on page 855, in an opinion by Mr. Justice Day, says:

> The question now propounded is: Was the trustee also entitled to a review in the Circuit Court of Appeals, under Section 24b, by petition for review? Under that section authority, either interlocutory or final, is given to the Circuit Court of Appeals to superintend and revise in matters of law and proceedings of the inferior courts of bankruptcy within their jurisdiction. We think this subdivision was not intended to give an additional remedy to those whose rights could be protected by an appeal under section 25 of the act. That section provides a short method by which rejected claims can be promptly reviewed by appeal in the Circuit Court of Appeals, and, in certain cases, in this court. The proceeding under section 24b, permitting a review of questions of law arising in bankruptcy proceedings, was not intended as a substitute for the right of appeal under section 25. Coder v. Arts, supra, p. 233. Under section 24b a question of law only is taken to the Circuit Court of Appeals; under the appeal section, controversies of fact as well are taken to that court, with findings of fact to be made therein if the case is appealable to this court. We do not think it was intended to give to persons who could avail themselves of the remdy by appeal under section 25 a review by petition under section 24b. The object of section 24b is rather to give a review as to matters of law, where facts are not in controversy, of orders of courts of bankruptcy in the ordinary administration of the bankrupt's estate. In our judgment the rule was well stated in Re Mueller (C. C. A., 6th Cir.), 14 Am. B. R. 256, 135 Fed. 711, 68 C. C. A. 349, by Mr. Justice Lurton, then circuit judge:
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> "The 'proceedings' reviewable (under Par. 24b) are those administrative orders and decrees in the

ordinary course of a bankruptcy between the filing of the petition and the final settlement of the estate, which are not made specially appealable under Par. 25a. This would include questions between the bankrupt and his creditors of an administrative character, and exclude such matter as are appealable under Par. 24a."

The case of Morehouse vs. Pacific Hardware Company, Supra. also holds that provisions for appeal and revision are mutually exclusive, and cites a number of cases in support of this and on page 180 of the American Bankruptcy Reports says:

> But, conceding the order to show cause to be a judgment of the court affecting a substantial right, we are of the opinion that a proceeding to punish for contempt one who has committed an act in violation of an injunction of a court of bankruptcy in a collateral matter, as in this case, is not a "proceeding in bankruptcy" which is subject to review in this court on original petition. Section 24 of the Bankruptcy Act of 1898, (Act. July 1, 1898, c. 541, 30 Stat, 553—U. S. Comp St. 1901, p. 3431—) establishes the appellate jurisdiction of circuit courts of appeals over "controversies arising in bankruptcy proceedings" and their jurisdiction in equity, "either interlocutory or final, to revise in matter of law proceedings of the inferior courts of bankruptcy." Section 25a provides for appeals from judgments in three certain enumerated steps in bankruptcy proceedings, "in respect of which special provision therefor was required." Holden v. Stratton, 191 U. S. 115, 10 Am. B. R. 786. 24 Sup. Ct. 45, 48 L. Ed. 116. There is in the language of the Act nothing to indicate that the revisory power so given to the circuit courts of appeals is more extensive than that which was exercised by the circuit courts under Bankruptcy Act March 2, 1867, c. 176, 14 Stat. 517. In Lathrop v. Drake, 91 U. S. 516, 23 L. Ed. 414, it was held that the appellate jurisdiction conferred on the cirucit courts by the Act of 1867 was of two classes of cases, one to be exercised

under a petition for review, the other by the ordinary appeal or writ of error. The same distinction has been recognized in construing the Bankruptcy Act of 1898, and it has been held that the provisions for appeal and for review on petition are mutually exclusive, and that the revisory jurisdiction does not include any orders or decrees which are appealable or reviewal on writ of error.

Whatever the situation may be, had an appeal been taken under subdivsion A of Section 25, of the Bankruptcy Act, and a petition for review been filed under subdivision B of Section 24 of the Bankruptcy Act, it is not presented here, for no appeal has been taken. It is now too late to take the appeal, for it must be taken within 10 days, and certainly petitioner cannot claim the benefit of having mistaken his remdy and ask that a petition to review may be treated as an appeal. He is only in that position if he has pursued both remedies.

Even if both remedies had been resorted to, it would be the duty of this Court to determine which of the two methods the Court is authorized to entertain, as each of these methods of procedure is exclusive of the other. This question has been set at rest by numerous decisions of this Court.

Bothwell v. Fitzgerald, et al., 34 Am. B. R. 261.

Matter of Creech Bros. Lbr. Co. 39 Am. B. R. 487.

The general consensus of opinion is that Section 25a, having provided a means of review by appeal three kinds of judgments, every other means is excluded.

First Nat. Bank of Miles City v. State National Bank, (9th Circuit) 12 Am. B. R. 440; 131 Fed. 430.

"Where an appeal properly taken under Section 25a involves only a question of law, it may be treated as a petition for revision."

In re William (9th Circuit) 156 Fed. 934. 19 Am. B. R. 389

That is the law of this Circuit, and an inspection of the petition in this case and the specifications of error (Tr. 5) clearly shows that there is something more than a question of law involved, and that questions of fact must be reviewed.

In the case at bar there is a controversy as to the facts, and therefore the matter is not one of law, but a mixed one of law and fact and can only be reviewed by appeal under Section 25a of the Bankruptcy Act.

> "Where the question as to the validity of a chattel mortgage in which the mortgagor claims priority is one of law only, depending on a statement of facts not contested, it is properly reviewable by a petition to revise under Section 24b of the Bankruptcy Act." In re Flatland (9th Circuit) 28 Am. B. R. 476.

THE MATTER IN CONTROVERSY HERE IS A CLAIM WHICH THE BANKRUPTCY COURT DECLINED TO ALLOW AS A PREFERRED OR PRIORITY CLAIM.

This being the case, the controversy comes therefore under clause 3, par. 25a of the Bankruptcy Act, which provides for an appeal "as in equity" from a "judgment allowing or rejecting a debt or claim of $500 or over" and is appealable under that section, and also under Section 24a as a controversy arising in bankruptcy proceedings.

This method of appeal is exclusive.

Matter of Creech Bros. Lbr. Co. (9th Circuit) 39 Am. R. 487.

In matter of Lane Lumber Company (9th Circuit) Vol. 33, Am. B. R. 497, it is held "a judgment denying the right to file a claim as secured and make substitute proof thereof after it has been allowed as unsecured in an amount exceeding $500 is only reviewable by appeal un-

der Section 25a of the Bankruptcy Act." "The proper test in determining the appropriate remedy for the review of the action of a bankruptcy court is what was the 'character of the proceeding' by which the jurisdiction of the Bankruptcy Court was invoked."

In re Mueller, Trustee, (6th Circuit), Vol. 14, Am. B. R. 256.

In Knapp v. Milwaukee Trust Co. 20 Am. B. R. 671, 162 Fed. 675, it is held: "Where, in answer to a trustee's petition for leave to sell the bankrupt's stock in trade, one claimed a lien upon part of the assets under the chattel mortgages which were found to be void, the order for leave to sell is reviewable only by appeal."

Loeser v. Savings Deposit Bank & Trust Co. 20 Am. B. R. 845.

THERE ARE QUESTIONS OF FACT TO BE REVIEWED AND THIS CANNOT BE DONE BY PETITION TO REVISE.

Section 24 of the Bankruptcy Act of July 1, 1898, gives the Circuit Court of Appeals authority to superintend and revise in matters of law the proceedings of the several inferior Courts of Bankruptcy within their jurisdiction. It was intended thereby to provide a summary method for revising the orders and decisions of Courts of Bankruptcy upon questions of law.

In re Grassler v. Reichwald (9th Circuit) Vol. 18, Am. B. R. 694.

Olmsted-Stevenson Co. v. Miller, (9th Circuit) 36 Am. B. R. 816.

In the case of In re Frank (8th Circuit), Vol. 25, Am. B. R. 486, it is held: "Decisions which require the consideration of conflicting evidence or evidence, though not conflicting, from which different deductions or con-

clusions may reasonably be drawn, may not be reviewed upon petition to revise under Section 24b of the Bankruptcy Act, but upon appeal only."

This is a petition for review by the Circuit Court of Appeals of the Ninth Circuit of an Order of the District Judge of the United States Court, District of Montana, affirming an order of the Referee in Bankruptcy.

STATEMENT OF CASE.

Petitioner, the Scandinavian American Bank, in its brief, has not made a full statement of the case and we believe that it will be well so to do in order that the Court may have a clear view of the situation.

On February 21, 1916, a petition was filed in the above District Court asking that the above named Bankrupt, be adjudged an involuntary bankrupt, and thereafter on the 15th day of March, 1916, an adjudication was made. Thereafter the matter was referred to Honorable E. M. Niles, Referee in Bankruptcy.

In the usual course, the Scandinavian American Bank of Big Timber, Montana, filed its claim with the referee, asking that its claim be allowed as secured claim. To this claim objections were filed by the Trustee and certain creditors asking that said claim be disallowed in part as a secured claim.

On June 29, 1915, W. N. Russell, being indebted to the Scandinavian American Bank of Big Timber, made, executed and delivered to the bank, a mortgage on certain real estate and a chattel mortgage on certain personal property, consisting of a stock of merchandise at Big Timber, to secure the payment of an indebtedness then existing to the bank and the sum of $300.00 advanced by the bank at the time of execution of the mortgages and a further advance of $250.00, as provided by the chattel

mortgage. The mortgages are made a part of the proof of claim.

The two mortgages were given to secure the payment of a note, dated January 29, 1915, in the amount of $4,165. (Tr. 65.)

The amount of the claim of the bank, and it asks that in its entirety it be allowed as a secured claim, is made up of the original note of $4,165.00, and three notes, one for $125.00, Exhibit D. (Tr. 66); one for $170.90, Exhibit E. (Tr. 67), and one for $170.00, Exhibit F., (Tr. 67), and further advances.

This indebtedness was secured by a mortgage on certain real estate in Big Timber, Sweet Grass County, Montana, and a chattel mortgage on certain merchandise in the possession of Bankrupt. At the time the mortgage was given the merchandise was left in his possession for the purpose of carrying on business, in the usual course, under the provisions of the chattel mortgage.

Bankrupt was engaged in the lumber, coal and cement business at Big Timber, prior to the giving of the note and mortgages in question, and up to the time he was adjudged a bankrupt.

The validity of the mortgage on the real estate is not in controversy, for at the time of the filing of the petition herein and the adjudication, the four months preferential period, had passed.

The value of the real property mortgaged was by stipulation agreed upon in the sum of $1,830.00. The bank therefore is entitled to its security to that amount, less cost of administration.

The chattel mortgage only is in a controversy and it is the contention of respondent that the balance of the claim of the Petitioner, The Scandinavian American

Bank, should not be allowed as a secured claim, and a lien on the proceeds of the sale of the merchandise for the reasons set out in the objections of respondent.

It is further conteded that even assuming the chattel mortgage is valid, that there were sales of merchandise made on credit to the amount of $1694.95 (Stipulation Tr. 98) which were made for the account of the Scandinavian American Bank and which would reduce the claim of the bank that amount, in addition to the amount realized from the sale of the real property even if the mortgage was valid.

The matter was heard before the referee and he filed his decision herein holding that the chattel mortgage was actually and constructively fraudulent as to the creditors of W. N. Russell and therefore to the trustee. The referee allowed the claim of the bank as a secured claim to the amount of $1830.00, the value of the real property. and held the chattel mortgage to be fraudulent and void, and disallowed the claim of the Scandinavian American Bank as a secured claim to the amount of $2790.90, and ordered that the bank be paid pro rata with the other creditors, to the amount of $2790.90. (Tr. 40.)

From this Order a Petition for Revision was presented to the Hon. Geo. M. Bourquin, Judge of the United States District Court for the District of Montana, (Tr. 41). Thereafter Judge Bourquin affirmed the Order of the Referee. (Tr. 55).

ARGUMENT.

The Scandinavian American Bank and W. N. Russell were doing business at Big Timber prior to the execution of the chattel mortgage. Russell for a period of nearly two years, and the bank commenced business about two weeks before the giving of the chattel mortgage. They

continued to do business at Big Timber up to the time of the adjudication.

Big Timber is a town of about two thousand inhabitants and the place of business of the bank and of W. N. Russell Lumber Company, are about three blocks and a half apart. (Tr. 279).

The Scandinavian American Bank filed its claim in the above matter as a secured claim. The amount of the claim is four thousand six hundred twenty dollars ninety cents, ($4620.90) with interest. Of this amount only four thousand one hundred sixty-five dollars, ($4165.00), the amount of the note given is secured by the real estate and the chattel mortgage. The balance of the claim is unsecured. Our position is that under the terms of the chattel mortgage notwithstanding the fact that the mortgage authorized two hundred fifty dollars ($250.00) additional credit, from the very terms of the mortgage itself; that is, that he was to buy for cash and do a cash business. he was prohibited from borrowing additional money to carry on the business.

This sum of four thousand one hundred sixty-five dollars ($4165.00) is secured by a real estate and a chattel mortgage. The chattel mortgage is the only one that we are concerned with in this inquiry. There is no controversy but that insofar as the bank obtains security by virtue of the real estate mortgage, it is entitled to the proceeds of the sale of the real estate mentioned in the proof of claim and the agreed value of this real estate is one thousand eight hundred thirty dollars ($1830.00), of which fifteen hundred dollars ($1500.00 has been paid to the bank and three hundred thirty dollars ($330.00) is in the hands of the trustee for the purpose of being used to pay the pro rata costs of administration. So the amount of the claim, insofar as we have to consider it is four

thousand one hundred sixty-five dollars ($4165.00) less one thousand eight hundred thirty dollars ($1830.00), leaving two thousand three hundred thirty-five ($2335.00), effected by the chattel mortgage. The value of the real estate being fixed by the order confirming the sale of the real estate.

It is claimed in the objections filed to the proof of claim of the Scandinavian American Bank that the chattel mortgage is fraudulent and void as to creditors of W. N. Russell and consequently fraudulent and void as to the trustee standing in the shoes of the creditors. (Tr. 19-20-21-22-23-24-25.)

We will not set out at length the reason for contending that it is fraudulent and void as to creditors, but will leave the court to ascertain those reasons from the objections filed by the trustee and creditors. (Tr. 18 to 27 inclusive.)

The objections are based on Section 70, subdivision A. par. 4, and subdivision E. of the Bankruptcy Act, which read as follows:

> "A. The trustee of the estate of a bankrupt upon his appointment and qualification, and his successor or successors if he shall have one or more, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt, as of the date he was adjudged a bankrupt, except insofar as it is to property which is exempt, to all 1....; 2....; 3....; 4.... property transferred by him in fraud of his creditors;...."
>
> "E. **The trustee may avoid any transfer by the bankrupt of his property which any creditor of such bankrupt might have avoided and may recover the** property so transferred, or its value from the person to whom it was transferred, unless he was a bona fide holder for value prior to the date of the adjudication. Such property may be recovered or its value collected from whoever may have received it,

except a bona fide holder for value. For the purpose of such recovery any court of bankruptcy as hereinbefore defined and any State court which would have had jurisdiction if bankruptcy had not intervened, shall have consurrent jurisdiction."

Section 6127 Revised Codes of Montana, 1907, is authority for the transfer being voided by creditors had bankruptcy not intervened.

The statute is as follows: "Every transfer of property, or charge thereon made, every obligation incurred, every judicial proceeding taken, and every act performed, with intent to delay or defraud any creditor, or other person, of his demands, is void against all creditors of the debtor and their representatives or successors in interest, and against any person upon whom the estate of the debtor devolves in trust for the benefit of others than the debtor."

Section 70, paragraph A, clause 4, has been construed repeatedly by the Courts, Federal and State and it has been held that the trustee may sue to avoid any conveyance which a creditor could have avoided, although more than four months prior to the adjudication of bankruptcy.

In Bush v. Export Storage Co., Vol. 14, Am. B. R. page 139, a case decided by the U. S. Circuit Court for the Eastern District of Tennessee, it is said:—

"This is a bill by a trustee in bankruptcy to have certain warehouse receipts declared invalid and set aside, so far as they are made a basis of a claim to material found on the premises of the bankrupt at the time of the bankruptcy proceedings were instituted.

"It may be important in this case, in the very outset, to determine the right which the trustees are undertaking to assert and enforce in this case, and the sources from which the trustees derive the right and remedy."

Sec. 70A of the Bankruptcy Law provides: "The trustee of the estate of a bankrupt, upon his appointment and qualification, ...shall....be vested by

operation of law with the title of the bankrupt, as of the date he was adjudged a bankrupt,.... to all.... (5) property which prior to the filing of the petition he could by any means have transferred or which might have been levied upon or sold under judicial process against him."

The trustee upon his appointment and qualification, is thus vested, by operation of law, without any deed of conveyance, with the title of the bankrupt, "as of the date he was adjudged a bankrupt."....In relation to a right or title thus derived by operation of law from the bankrupt himself, it is very true and well settled, that the trustee takes just such title as the bankrupt had, and no better or greater title, and subject to estoppel as to liens or equities to which the title was subject in the hands of the bankrupt.

But this proposition, although well settled, does not meet or dispose of the contention here presented, for the right which is asserted by the trustee in the present suit was not derived by operation of law from the bankrupt, and the remedy being pursued is not one which was available to the bankrupt. The right here asserted, and the remedy adopted to enforce that right, passed by operation of law, not from the bankrupt itself, but from creditors of the bankrupt, and in their right, and not by any remedy which passed by operation of law, from the bankrupt. And so this suit does not involve those provisions of the bankruptcy statute which vest in the trustee the right to avoid certain defined transfers declared invalid by the Bankruptcy Act itself, and to recover the property fraudulently conveyed. Transfers which are deemed fraudulent in Bankruptcy and so declared by the Bankruptcy Act itself, are, first, conveyances and transfers, by which a creditor obtains a preference of his claim over other creditors; second conveyances which are intended to hinder, delay and defraud creditors; and third, (Sec. 67 E. Clause 3) transfers, void as to creditors under the local laws of the several states; but these transfers are prohibited, and authority vested in the trustee

to set them aside, only when made within four months

But besides this class of transfers made void by the Bankrupt Act itself, as being against its policy of equal and fair distribution, the bankruptcy law (Sec. 70 A. subsec. 4), provides that the trustee shall be vested by operation of law with any property transferred in fraud of his creditors, the precise language of the Act, being, "transferred by him in fraud of his creditors."

There is no four months limitation on this class of transfers, and the provision includes fraudulent conveyances which are so by the common law, by statute law, and by any other recognized law of the State. Loveland on Bankruptcy (2nd. Ed.) sec. 158 and cases cited. Of course, the fraudulent bankrupt is without right to set aside a conveyance made by him in fraud of his creditors. It is valid between the parties, but by operation of the very terms of the act, the right which before bankruptcy belonged to the creditors passes from them, and is vested in the trustee.

Fraud, actual or constructtive, is a necessary element to give the trustee in bankruptcy a right of action; and the trustee may avoid any transfer by the bankrupt of his property which any creditor of such bankrupt might have avoided, and may recover the property so transferred, or its value, from the person to whom it was transferred, unless he was a bona fide holder for value prior to the adjudication.

The language of section 70 E is as follows: "The trustee may avoid any transfer by the bankrupt of his property which any creditor of such bankrupt might have avoided, and may recover the property so transferred, or its value, from the person to whom it was transferred, unless he was a bona fide holder for value prior to the date of adjudication. Such property may be recovered or its value collected from whoever may have received it, except a bona fide holder for value."

It is quite obvious enough that the bankruptcy statute has vested in the trustee this comprehensive

power to set aside, in favor of the creditors, **conveyances which the creditors of the bankrupt might have avoided,** subject to the qualifications of limitation found in Sec. 70 E, which provides, in terms, that the trustee, "may recover the property so transferred, or its value, from the person to whom it was transferred, unless he was a bona fide holder for value prior to the adjudication. Such property may be recovered or its value collected from whoever may have received it, except a bona fide holder for value....."

In the case of In Re Wm. H. Gray, 3 Am. B. Rep. 647, the Supreme Court of New York also construes this Bankruptcy Act, and it says in part as follows:

"It has also been held that such voluntary assignment though general and non preferential, if made within four months prior to the filing of the petition, is a constructive fraud upon the Bankruptcy Act, in that it interferes with the control of the assignor's estate by the court in bankruptcy and prevents the due operation of the bankruptcy system ..... It is provided in Sec. 67 E. of the Act that all conveyances, transfers and assignments of this property within four months by a person so adjudged a bankrupt, with the intent to hinder, delay and defraud his creditors, shall be null and void as against such creditors, except as to purchasers in good faith and for a present fair consideration; and that the property so conveyed, transferred or assigned shall be and remain a part of the assets of the estate of the bankrupt and shall pass to his trustee, whose duty it shall be to recover, the same by legal process or otherwise for the benefit of the creditors. This section embraces all acts however innocent in themselves, which are frauds upon the bankruptcy Act; and consequently Gray's general assignment, though as a matter of fact untainted with fraudulent purpose, was yet, as matter of law, made with intent to hinder, delay and defraud the assignor's creditors within the meaning and purpose of the act."

Sec. 67 E. undoubtedly covers as well transfers which are fraudulent as a matter of fact, if made

within four months. It is apparent however, that this section does not embrace fraudulent transfers which, like those under consideration, antedate four months.

To reach such fraudulent transfers section 70 E. seems to be specially adapted. That provides that "The trustee may avoid any transfer by the bankrupt of his property which any creditor of such bankrupt might have avoided, and may recover the property so transferred, or its value, from the person to whom it was transferred, unless he was a bona fide holder for value prior to the date of the adjudication."

It will be observed that there is here no four months limitation, and it is plain that the limitation which runs through the act in connection with frauds on the system was at this point advisedly omitted. The purpose of the two sections is quite apparent. One covers frauds upon the act, whether actual or constructive, committed within the four months; the actual or common law frauds exclusively, committed at any time. When the trustee seeks to annul the former, he does so in the right which the due operation of the act confers upon him. That right is given by Sec. 67 E, fortified by the title conferred upon him in terms by Sec. 70 A. subd. 4, and he may exercise that right, though the nature of the transfer be such that but for the act, no one or all of the creditors could avoid it.

When, however, the trustee seeks to avoid a fraudulent or any avoidable transfer by the bankrupt antedating the four months, he does so, not in the right conferred as a concomitant to the due operation of the system, but exclusively in the creditors' common law right. He is, with relation to these anterior transfers, so to speak, subrogated to that right. Such of these anterior transfers as any creditor might have avoided, he may avoid. Such as no creditor could have avoided, he cannot avoid.

. . . . Nor was it intended to leave avoidable transfers antedating the four months to the operation of ordinary creditors' bills. No individual creditor is permitted, by the bankruptcy Act, to proceed upon

his judgment against the bankrupt. Should he attempt to file a creditor's bill thereon, he would at once be stayed by the Bankruptcy Court. **Sec. 70 E. therefore, means what we have indicated or else the Bankruptcy Act operates as a legislative device to permit fraudulent transfers to take effect with impunity in case they are successfuly concealed for the specified four months. And this, certainly, cannot be inferred."**

In Beasley v. Coggins, 12 Am. Bankruptcy Rep., 358, the Supreme Court of Florida, has the following to say:

"Sec. 67 E, treats of conveyances, transfers, etc., made by a bankrupt within four months prior to the filing of the petition, with intent to hinder, delay or defraud creditors."

Some of the Federal Courts have found difficulty in reconciling these sections of the Bankruptcy Act, but it seems to us that the views expressed in In re Mullon, 4 Am. B. R. 224, 101, Fed. 416, are substantially correct. It is there said that section 70 E was intended to provide simply that the trustee in Bankruptcy should have the same right to avoid conveyances as was possessed by creditors, or any of them, and this with special reference to the statute of 13 Elizabeth. **Under the Bankruptcy Act, when one is adjudged a bankrupt, creditors are not permitted to attack fraudulent conveyances of their debtor, made more than four months of the adjudication of bankruptcy; and if the trustee could not do so then the act would constitute "a device to permit fraudulent conveyances to take effect with impunity in case they are successfully concealed for the specified four months."**

In In Re Scrinopskie, 10 Am. Bankruptcy Rep. 221, page 224, the U. S. District Court, for the District of Kansas says:

"So far as the merits of the controversy are concerned, it plainly appears from the evidence that the property claimed by the intervenor was originally the property of the bankrupt, and, in my judgment,

the pretended sale by the bankrupt to his brother was a subterfuge without consideration, and with the express purpose of hindering and defrauding his creditors.

The fact that such transfer was made more than four months prior to the adjudication can make no difference."

The United States Circuit Court of Appeals for the Seventh Circuit, in an opinion by Circuit Judge Jenkins found in In re Rodgers Vol. 11, Am. B. Reports on page 93 has this to say:

"We are therefore brought to the question whether, under the Bankruptcy law, the trustee takes solely in the right of the bankrupt, or whether he also represents the rights which creditors have, and the authority to enforce them; whether the petition in bankruptcy is merely the appropriation by the bankrupt of his property to his creditors, **or an assertion in behalf of the creditors of rights which they had independently of the bankrupt, which he himself could not assert.** Notwithstanding some loose expressions in the decisions on this subject, we are satisfied, from a careful scrutiny of the act, that the filing of the petition is something more than the dedication by the bankrupt of his property to the payment of his debts; that the trustee is not only invested with the title of the property, but since, after the filing of the petition, the creditors are powerless to pursue and enforce their rights, the trustee is vested with their rights of action with respect to all property of the bankrupt transferred or incumbered by him in fraud of his creditors, and may assail, in behalf of the creditors, all such transfers and incumbrances to the same extent that creditors could have done had no petition been filed."

Collier on Bankruptcy, 10th Edition, pages 1002 and 1003, says:

"c. Property Fraudulently Transferred—(1) In General.—By subdivision 4 property transferred by the bankrupt in fraud of his creditors passes to his trustee. This is the converse of the doctrine that

trustees take title subject to equities; they also take title to property which the bankrupt has fraudently transferred, and, in which, therefore ,the creditors have equities. The Trustee's interest in such property is stronger than was that of the creditors in whose stead he stands, for he has a title. The trustee is vested not only with the title of the property but also with the creditors' rights of action with respect to property of the bankrupt fraudulently transferred or incumbered by him, and he may assail in their behalf all of such transfers and incumbrances to the same extent as though the debtor had not been declared a brankrupt. Where after the filing of an involuntary petition and before adjudication a creditor attaches the bankrupt's assets, the trustee may recover the proceeds of the attachment, even though they were less than the percentage to which the creditor would have been entitled in the bankruptcy proceedings. It is apparent that this provision applied to all property transferred by the bankrupt at any time in fraud of his creditors. If actual fraud be shown, as where a bankrupt while insolvent transfers real estate to his brother for an inadequate consideration, and the transfer was not recorded, the transfer may be set aside. The trustee's remedy when title is claimed adversely is, as has been seen, usually a suit in the proper court. This subdivision should be read in connection with Par. 23, par. 67-e and par. 70-e."

In Holbrook v. International Trust Company, Vol. 33, Am. B. R., page 808, it is held:

"Section 70-e of the Bankruptcy Act merely gives the trustee in Bankruptcy authority to avoid any transfers of property made by the bankrupt 'which any creditor' might have avoided, and the question whether a particular transfer was or was not fraudulent as to creditors under the Act depends upon the laws of the State which govern the transfer of the property in question."

Moore on Fraudulent Conveyances, Vol. 2, pages 1182-1184.

In the case In re Garcewich 8 Am. B. R., page 152, we find the following:

"Under the present Bankrupt Act, as under previous bankrupt acts, the trustee takes the property of the bankrupt, **in cases unaffected by fraud,** in the same plight and condition that the bankrupt himself held it, and subject to all the equities impressed upon it in the hands of the bankrupt, except where there has been a conveyance or incumbrance of the property which is void as against the trustee by some positive provision of the act. (Cases cited). **It is not the meaning of the present act that the institution of proceedings in banqruptcy should secure immunity to the title of fraudulent vendors or mortgagors, and deprive creditors of a resort to property, out of which, but for the proceedings, they could have satisfied their claims.** Sec. 70 declares in express terms that the title of the bankrupt shall vest in the trustee to 'all property which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him'. That language is sufficiently comprehensive to vest the trustee with title to all property of the bankrupt as against the fraudulent title of another."

THE FRAUD ALLEGED IN THE OBJECTIONS INVALIDATES THE MORTGAGE UNDER THE LAWS OF THIS STATE.

Our contention is that the chattel mortgage was actually and constructively fraudulent and we contend this is shown by preponderance of the evidence and that the referee was justified in setting the chattel mortgage aside as fraudulent, and that the order of the District Judge was also correct.

We will take up the different allegations of fraud alleged in the objections, in the order in which they are

alleged, and endeavor to point out the evidence sustaining these objections.

There is no contention but that mortgages of the kind under consideration are valid, providing they are entered into in good faith, with honest intentions, providing further, that the parties thereto carry it out in good faith.

The case of Noyes vs. Ross, 23 Mont. 425; 59 Pac. 367, goes into the question very thoroughly and is the leading case in the State of Montana and we desire briefly tto refer to it. The court says on page 436 o fthe Montana report:

> "If the debt was one honestly due, the mortgagors had a right to secure it, whether due to a relation or anyone else, even though their action left nothing for their other creditors,provided, always, the transaction was in good faith, and entered into with honest intention."

The first proposition of law, stated by counsel for petitioner to the effect that chattel mortgages of this kind are valid, is hardly a correct statement, for it leaves out the question of the subsequent good faith of the parties to the transaction. With this modification, we have no fault to find with the first statement of law made by counsel.

THE CHATTEL MORTGAGE WAS NOT MADE IN GOOD FAITH BETWEEN THE PARTIES TO THE INSTRUMENT.

Th counsel's first proposition of law is that the mortgage is valid if when made in good faith, we insist that it should me modified to the extent that it must also be carried out in good faith.

In the present case however, we insist that it was not made in good faith, in so far as the rights of creditors and the trustee are concerned, and that the evidence supports this finding of fact of the Referee and the District Judge

and justifies the tenth allegation of the objections. (Tr. 18 to 24.)

On page 64 of the transcript, Mr. Moe, the cashier of the Bank, in response to a question of his counsel relates the circumstances incident to the making of the loan and he states as follows:

> "Mr Russell had borrowed money from us from time to time, and we had quite a number of notes in the pouch and practically all of them were past due, and knowing Mr. Russell's condition that he was owing quite a bit besides what he owed us, we got Mr. Russell in there one day and took a note for the full account of his indebtedness to us at that time, which was also secured in chattel and real estate mortgage, and told him that we would be willing to carry him for this money; that we would like to see him make out and we would be willing to carry him as long as he kept his stock up in shape and his business was done, and that it was perfectly agreeable to us that he pay off the other creditors, as long as he did not run his stock down and took care of his business."

Again on pages 76 and 77 of the transcript on Cross Examination, Mr. Moe states:

> "Q. Now, Mr. Moe, you stated that the understanding was, when this chattel mortgage was given and this loan made, that Mr. Russell was to keep his stock in shape and keep it up and do business right?
>
> A. We told him that was about as strong as we could possibly go with him, and he would have to try to conduct his business a little better and we would be glad to stay with him as long as he was attending to his business and taking care of his outstanding creditors and that we were willing to carry him.
>
> Q. You mean the creditors that were in existence at the time this mortgage was given?
>
> A. The creditors he had outside of the bank.
>
> Q. Did you make any inquiry from him as to

how much was owing at that time to his creditors, outside of the bank?

A. I do not remember whether he made us a statement at that time or not.

Q. Do you know whether you made any inquiry of him?

A. I think we did, we talked it over.

Q. And the understanding also was at that time that after the giving of the chattel mortgage, he was to keep his stock up and not permit it to run down?

A. Naturally when a bank owns chattel property, they want a man to take care of it.

Q. You stated that he was to pay off his other creditors, which he testified to, that was to be done out of the proceeds of his sales of merchandise from time to time subsequent to the giving of that mortgage?

A. We told him to take care of his bills.

Q. But he was to take care of his bills to his creditors, was he not, out of his daily business?

A. Yes."

The Bankrupt W. N. Russell on page 89 of transcript with reference to the execution of the chattel mortgage says:

"Q. What was said at the time of the execution of this mortgage, either by Mr. Campbell or Mr. Moe, with reference to this chattel mortgage and what you were to do in connection with it?

A. They were both there when I asked if I should keep a record and daily account of what I was doing, and they said that would not be necessary, and I then asked them if I should come in the first of the month with statement of what I was doing, and they said, no, that they would call for a statement when they wanted one."

W. N. Russell, page 92 of the transcript, with reference to the keeping of his bank account says:

"Q. You kept your bank account where?

A. With the Scandinavian American Bank.

Q. Subsequent to the 29th day of June, 1915?

A. Yes.

Q. In whose name did you keep it?

A. W. N. Russell.

Q. Did you keep an account in the Scandinavian American Bank in any other person's name?

A. No.

Q. When you made your deposits in the bank, did you at any time subsequent to the 29th day of June, 1915, deposit money in the Scandinavian American Bank, or any other bank to the credit of the Scandinavian American Bank?

A. No.

Q. The proceeds and the receipts of your business from sales and moneys collected after deducting the necessary expenses of carrying on your business and for the payment of current bills? Where were they deposited, Mr. Russell?

A. In the Scandinavian American Bank.

Q. To whose credit?

A. W. N. Russell.

Q. All of this money that was deposited in the Scandinavian American Bank to the credit of W. N. Russell, who was it checked out by?

A. W. N. Russell.

Q. On checks signed by whom?

A. W. N. Russell.

Q. By anybody else?

A. No.

Q. After these amounts that were deposited in the Scandinavian American Bank to your credit subsequent to the giving of this chattel mortgage on the 29th day of June, 1915, were any of the moneys deposited applied on the payment of this $4165.00 note?

A. No.

Q. Or to any other note that you gave to the bank that was covered by this mortgage?

A. No."

Mr. Moe was the cashier of the bank during the entire period. (Tr. 69). With reference to this matter he says: (Tr. 249).

> "Q. Now, that account was kept with W. N. Russell subsequent to June 29, 1915, and up to the date I've mentioned in the same manner that it was kept prior to the giving of this chattel mortgage and during the time that he was doing business with the bank?
>
> A. The same system of book keeping?
>
> Q. Yes.
>
> A. Yes, sir.
>
> Q. And there was no change in his account, it was kept in the same heading and the account followed on after June 29th, 1915, just the same as it had beep kept as to method and system, as before?
>
> A. It was kept in the same manner, yes, sir.
>
> Q. And under the same heading?
>
> A. W. N. Russell."

We contend that this shows very clearly that from the very inception of the transaction, the bank did not require the provisions of the chattel mortgage to be lived up to and that Russell did not intend to live up to them.

The evidence which we will refer to hereafter shows that money, from the sales of merchandise was applied on indebtedness existing at the time of the giving of the chattel mortgage in question and contracted prior thereto

On page 30 of their brief, counsel for the bank seek to justify this and they say:

> "Exhibits from one to thirty-six are evidence of debts paid by the bankrupt, which were authorized under the terms of the mortgage. Had these bills not been paid, credittors would have then brought suits. The bank by the terms of the mortgage waived its lien to the receipts to this extent. To continue in business Russell must buy and sell, and in order to buy he must pay previous bills. Some of the bills he paid were incurred prior to the execution of the mort-

gage. Russell's debts before the mortgage continued to be Russell's debts after the mortgage. They were still the liabilities of the business. The mortgagee did not try to and could not have suspended payment of the debts incurred prior to June 29, 1915. Failure to pay for a car load of lumber sold to him on June 25th before the mortgage would have the same result as failure to pay for a car on July 5th after the mortgage. In either case he could not continue to buy unless he paid and if he could not buy he could not sell. But if this problem is viewed from another angle, it is difficult to see how these payments could prejudice the other creditors, who, but for them would have received nothing, and who are through the trustee objecting to the allowance of the bank's lien as a preferred claim, and are the people who received payments upon bills."

We therefore contend, that it was the intention of the bank and Russell that he was to continue and carry on his business in the same way that he did prior to the giving of the chattel mortgage, and that the sole idea of the bank and Russell was to work the business out if possible.

This idea may have been a laudable one but it was a fraud upon the creditors then existing and upon the subsequent creditors who never received anything at all, who had a right to rely upon the provisions of the chattel mortgage being honestly and fairly carried out, for they had no security and the bank did.

Our Supreme Court in the case of Noyes vs. Ross, Supra. says:

> "A mortgage which authorizes the mortgagor to retain possession with the right to sell a stock of goods mortgaged, in the ordinary and usual course of trade, if otherwise good, is on its face a valid instrument, provided that it appears therein that such sales were to be for the benefit of the mortgagee, and he is to account to the mortgagee for the proceeds of the

sales.. To this EXTENT the courts and text writers have advanced in later years. We must remember that, as a substitute for posssesion in the mortgagee, the mortgage must be filed in the office of the County Clerk. Secrecy is thus obviated, and opportunity to perpetuate fraud is greatly lessened. The records are public, and creditors are thereby constructively advised of the nature and provisions of the contract granting the lien. It is the policy of the recording acts that has outweighed the policy of the older rule, under which, under the theory of constructive fraud mortgages with power to sell the mortgaged goods in the usual course of trade, with right to sell, cannot be said by judges to be the result of fraudulent intentions on the part of the parties to them, unless such intention existed in fact.

In Noyes vs. Ross, Supra, page 44, our Court says:

"But will be upheld or condemned according as the arrangement is entered into and carried out in good faith or not."

The provisions of the chattel mortgage permitting sales of merchandise for not to exceed thirty days' credit or for cash, was violated by Russell, with the knowledge and consent of the Bank.

We take the position that these sales were made for the account of the Bank, the mortgagee, and if this were the only provision of the chattel mortgage violated, no one could complain, but the other provisions violated show that it was the intention to totally disregard this also and it is one link in the chain, therefore question is of some importance.

In discussing this question counsel for the Bank say: That Russell denied giving credit for any period to exceed thirty days (Brief page 12), and they say on page 14 of the brief that the Bank was not a fraudulent party thereto. On page 93 of the transcript Russell admits that he sold merchandise on credit.

It was stipulated that between the 29th day of August, 1915, the date of the giving of the chattel mortgage and up to the time of the filing of the petition herein, that merchandise to the amount of $1694.95, was sold on credit and was unpaid at the time of the filing of the petition. (Tr. page 99.)

It is argued by counsel that because Russell did not sell on credit to exceed thirty days that there is no violation of this provision of the chattel mortgage and the Bank did not know of it and was not a fraudulent party thereto. The Bank did, however, know of it. On page 228 to 230 of the transcript, Russell in his testimony says:

> "Q. Did Mr. Moe ever ask you what you were doing with the money taken in every day and the profits of your business?
>
> A. Yes, sir.
>
> Q. Where did you tell him they were going to?
>
> A. I told him it was taking all that was coming in to keep up my stock and keep going, which it was doing. I was holding out too much credit which I found out afterwards was impossible to do, and he told me so at the time.
>
> Q. When did he tell you that?
>
> A. Probably once or twice every month when he thought I should be advised to back off on giving so much credit a little bit.
>
> O. Then you discussed with Mr. Moe the question of your giving too much credit—did you?
>
> A. I did not discuss it with him. I asked him, told him the parties to whom I was giving credit in the lumber business. I didn't ask him if he should give so and so credit. In the lumber business if we're going to give a man credit we tell him "Yes" and go ahead and load him up and get away with it.
>
> Q. He told you at least two or three times a month you were giving too much and too long credit?
>
> A. No, that's not what he told me.

Q. What did he tell you?

A. I never told him the length of time I was giving credit. As a matter of fact I made it a point to never give a man over 30 days but as I found out 30 days meant anywhere from 30 days to never.

Q. So you discussed that phase of it with Mr. Moe, did you?

A. Well, I did not discuss it with him as to how long it was, these accounts coming in, etc., and so on; but I did tell him when he asked who I was giving credit to, those I had in my mind, I told him about.

Q. And you told him when you spoke of these accounts, what credit had been given and how old they were and all that kind of thing—you discussed with him—did you?

A. I can't say I ever told him how old any of them were.

Q. Did he ever inquire?

A. As to that I don't know.

Q. Did he ask you, Mr. Russell, why these accounts weren't collected and all that kind of thing?

A. No, I imagine that he knew as well as myself why they were not collected in."

It will therefore be seen that Moe, an officer of the Bank and the cashier, its principal officer, knew the way of giving credit and his knowledege is the knowledge of the Bank.

It will not do to say that merchandise could be sold on credit without any distinct giving of credit to exceed 30 days, that because the accounts were not paid between thirty days, it is not an intentional sale and a violation of mortgage. For the protection of creditors, it was the duty of Russell and the duty of the Bank to see that this provision of the motrgage was honestly carried out and if they could not carry it out, then it was their duty to cease doing business.

It is not an answer to this that the sales were solely

for the credit of the mortgage, and no one was being hurt for the reason, that the sales on credit might have been in excess of the amount due to the mortgagee.

While on this subject, we desire to urge that these sales to the amount of $1694.95 were made on the account of the Bank and even if the Court should find that the chattel mortgage itself was not fraudulent, that amount would have to be deducted from the $2790.90 due to the bank, after it applied on the amount of its claim, the value of the real property, the Bank would only be a secured creditor for the balance.

The case of Noyes vs. Ross, supra. is authority for this position and the Court on page 445 says:

> "Nor were they (creditors) hurt by an extension of a credit for thirty days because, as against them or any unsecured creditor in like position all sales, whether cash or for credit were to be accounted for; and we are of the opinion credit sales should, as between mortgagors and mortgagee, all be deemed cash payments....although....the credit may not have been collected, and may in fact have been unpaid at the time of the accounting."

The court cites numerous cases in support of this proposition.

The cases of Howard vs. Wulfekuhler (Kan.) 13 Pac. 366, and Atchison Saddlery Co. vs. Gray (Kan.) 64 Pac. 987, are cited by counsel for the Bank, are not in point. In these cases the contention was made that a violation of the provisions of the mortgage by the mortgagor without the knowledge of the mortgagee, renedered the mortgage invalid. These cases are not in point for we claim that the Bank in this case had actual knowledge.

THE PROVISION OF THE CHATTEL MORTGAGE AUTHORIZING THE MORTGAGOR TO SELL FROM HIS STOCK OF MERCHANDISE, KEEPING ACCURATE ACCOUNT OF SUCH SALES AND DURING BANKING HOURS OF EACH DAY DEPOSIT TO THE BANK, AFTER PAYING CURRENT BILLS AND EXPENSES OF CARRYING ON BUSINESS, WAS VIOLATED.

The next provision of the chattel mortgage which we claim was violated is the provision that Russell was to keep an accurate account of all sales and during Banking hours of each day deposit the proceeds of such sales in the Bank of the Mortgagee to the credit of the Bank to apply on the note secured by the mortgage retaining only in his office, sufficient to pay current bills and expenses of carrying on the business and for making change.

It does not need any argument or quotation from the testimony to show that this provision of the chattel mortgage was never complied with, and was never intended to be complied with.

At the time the mortgage was given, Russell had his account in his own name with the Scandinavian American Bank, the mortgagee. No change was made in the method of handling this, from the time the mortgage was given until the petition was filed. Russell kept his account and deposited all the proceeds of the business, in his own name with the Scandinavian American Bank, the mortgagee. Placed money in daily, check it out daily. There were never any of the proceeds of the business deposited daily or at all in the Bank of the Scandinavian American Bank to its credit as required by the terms of the chattel mortgage. Russell was permitted to check it out as he saw fit, pay it to whom he saw fit; to attorneys who had

accounts against him, even to the extent of paying money to his brother, and cousin, and to the Scandianvian American Bank itself, just as he pleased. In other words he was permitted to conduct the business as if the chattel mortgage did not exist; and during the period his deposits amounted to Eight Thousand Seven Hundred Three and 35-100 ($8,703.35) Dollars (Tr. page 28.)

Russell was not ignorant of what he was doing and certaintly the officers of the bank were not ignorant, for these checks passed through the Bank and were subject to daily inspection and at times his checks were not paid because he was overdrawing his account, at other times he was permitted to overdraw his account.

The plain provision of the mortgage was broken and it was the duty of the Bank, from the beginning to have this money deposited in this Bank to its own credit day after day so the provisions of the mortgage could be carried out.

We have drawn the attention of the Court to the testimony showing that the Bank account of Russell was kept in his own name, and that the moneys paid into the Bank were withdrawn by him and none of it applied to the reduction of the mortgage indebtedness.

On page 93 of the transcript, Mr. Russell states:

> "Q. After these amounts that were deposited in the Scandinavian American Bank to your credit subsequent to the giving of this chattel mortgage on the 29th day of June, 1915, were any of the moneys—deposited applied on the payment of this $4165.00 note?
>
> A. No.
>
> Q. Or to another note that you gave to the Bank that was covered by this mortgage?
>
> A. No."

The purpose of the provision is perfectly plain; it

means that after paying the running expenses of the business, expenses of carrying on the business and his living expenses, the balance was to be deposited in the Bank daily and thereafter on the 10th of each month an accounting was to be had and at such time the proceeds of sales and collections, were to be turned over to the Bank and applied on the promissory note.

This provision of the mortgage was intended to keep the business of Russell on a cash basis and prevented him from using, except for the purposes heretofore mentioned, the moneys received from his business.

This was not done and he was allowed to spend his money as he pleased.

If daily the money had been paid into the Bank to the credit of the Bank, it could not have been checked out by Russell.

Counsel in their argument say of those large sums to which reference is made, "there was not a dollar at any time that Russell did not owe for current bills and the expense of carrying on his business of the provisions of the mortgage."

> "The only inevitable conclusion to be drawn from the evidence is that, from the moment the mortgage was given to the date of the filing of the petition, in bankruptcy Russell did not have one penny of profit to apply on the mortgage debt, and because of the fact that the bank, knew of this condition no deposit of the proceeds of such sales of the mortgagee herein to the credit of the party of the "second part to apply on the note herein mentioned, was ever made. There was never any surplus to apply. Russell's receipts from day to day and more were covered by his debts. These had to be met in part at least, or go out of business." Brief pages 18-19.

This is the whole story in a nut shell. He was using the proceeds of the sales of merchandise not only to meet

current expenses and purchases of merchandise but to pay his indebtedness.

Counsel say that Russell did not have "One penny of profit to apply in reduction of the mortgage debt."

This is not the point in issue. The mortgage did not provide that profits were to apply on the reduction of the mortgage debt, but it provided that the proceeds of sales of merchandise less current expenses and money required for the purchase of merchandise were to be so applied, so that a corresponding reduction in the security would work a corresponding reduction in the indebtedness.

THERE WAS NO ACCOUNTING ON THE 10TH DAY OF EACH MONTH.

The next provision of the chattel mortgae provides in substance that at least once a month on or before the 10th of the month during the continuance of the mortgage Russell was to account to the Scandinavian American Bank, for all sales and collections made during the previous month and pay over to the Bank, at such times of accounting, the proceeds of such sales and collections to apply toward the payment of the promissory note, after deducting the actual and necessary expenses of carrying on the business, the actual and necessary living expenses of Russell and after deducting enough to pay bills falling due, for goods purchased to replenish said stock of merchanrise. The testimony shows that there was never any written accounting and as a matter of fact it shows that no system of books was kept by Russell, at any time by means of which he could make such an accounting and none in fact was made.

The Bank knew that Russell was in difficulties and

that every attorney in town, as Mr. Moe puts it, was trying to collect from his (Tr. 64-75 and 76.

Mr. Moe testified that the Bank never made any examination of Russell's books (Tr. 86), that Russell never gave any financial statement in writing (Tr. 86), that Russell never gave any statement, in writing, on the 10th day of any month, during the time the chattel mortgage was in force. (Tr. 86.)

Russell testified that he kept no books of account or of his creditors. (Tr. 25-26-27).

Russell testified (On page 89-90 Tr.) that he never made any statement of his business dealings, in writing, that he made no verbal account but told them such things as they asked him (Tr. 89-90 Tr. 227).

Russell testified (Tr. 90) that he kept no books or other accounts of his daily receipts and sales and that he had no means of ascertaining, from books, the amount of his sales during any part of the month.

The attorneys for the Bank do not dispute this but they insist on Page 16 of their brief, the Bank was at all times able to determine the financial standing of Russell. Russell was not able to do so himself. Counsel state on Page 17 of their brief that Russell was not competent and was not able to draw up a formal report of his assests and liabilities.

On Page 15 of their brief counsel state that it was not incumbent upon them to install entirely a new system of "Bookkeeping". We do not make any such contention, but we do insist that this chattel mortgage called for a monthly accounting between Russell and the Bank, as such accounting is understood, and it should not be guesses and conjectures.

> "Accounting is rendering or delivering a formal statemen of one's dealings (1Cyc. 364)."

Account is a written statment of pecuniary transactions (1 A. & E. Enc. Law. Second Ed. 434)."

We submit that this is the kind of accounting that was contemplated by the provisions of the chattel mortgage in question.

We do not see that the citations by counsel in this connection (1 C. J. 596) help them in the least but they all bear out the theory of the above definition.

RUSSELL WAS PERMITTE DTO PURCHASE AND HE PURCHASED MERCHANDISE ON CREDIT

The records show that there was a large amount of merchandise purchased from persons whose claims had been filed in this court, subsequent, to the giving of the chattel mortgage for which they have not received one dollar, either in cash or its equivalent. Russell knew it and knew the provisions of the chattel mortgage (Tr. 93-94).

It is claimed that the Bank did not know that he was purchasing merchandise on credit.

Mr. Moe, however, did know that he was purchasing merchandise on credit and he stated in his testimony that he expected him to do so (Tr. 84-85).

Independent of this however, our position is that the Bank was obliged to know, it assumed some obligation when it executed this chattel mortgage.

Had it received each month an accounting from Russell it would have shown what money he took in from the sales of merchandise, what money he paid out and how, what merchandise he had received during the month, and whether it was paid for or not.

All this merchandise went into the Lumber Yards of Russell. A portion was in there at the time he was adjudged a Bankrupt and now the Bank wants to put their

hands on the merchadise and take it to apply on the mortgage indebtedness. In other words because these subsequent creditors were foolish enough to give credit, notwithstanding the mortgage, was on record, then they should stand the loss.

They had a right to reply on the integrity of the Bank and that it would see to it that the mortgagor would comply with the provisions of the mortgage.

In commenting on this phase of the chattel mortgage, counsel for the Bank say:

> "Admitting every contention of the objectors to be true still the facts show that the objectors with full knowledge of the mortgage which was of record in Sweet Grass County, shared in every payment made in alleged violation of its terms. To such as these it is submitted the doors of this Court ought to be closed." (Brief, Page 22).

Counsel further say that these creditors are estopped.

The transcript shows the claims filed by these different creditors, that they were not residents of Montana and that their place of business in every instance ,was outside of Sweet Grass County. There is nothing in the testimony to show that these creditors, living outside of Sweet Grass County and State of Montana, had actual notice of this chattel mortgage.

Even if we concede that the filing of the chattel mortgage would be constructive notice to these non-residents, who sold merchandise on credit to Russell, after the giving of the chattel mortgage; these sales to Russell made subsequently raise no question of estoppel against creditors whose claims have been filed for merchandise sold to Russell, prior to the giving of the chattel mortgage and these claims in amount are in excess of the value of the presonal property covered by the chattel mortgage and

the assets of the estate, as we will hereafter show; some creditors received nothing, surely they have a right to complain.

We now desire to briefly draw the attention of the Court to the purchases of merchandise made subsequent to the giving of the chattel mortgage as shown by the proofs of claim offered in evidence and the testimony of Russell relating thereto.

It shows also that this merchandise was received by Russell, taken into and used in his business, and is a part of the property which passed into the hands of the trustee and which is now claimed by the Bank, under the provisions of the chattel mortgage. (Exhibit 45, claim of Pacific States Lumber Company, Tr. 142-144-149-151-161).

The amount of this claim is $379.22.

Exhibit 50, claim of Bloedel Donovan Lumber Company (Tr. 151). The amount of this claim is $621.56.

Exhibit 54, claim of Dakota Plaster Company (Tr. 174). The amount of this claim is $49.40.

Exhibit 55, McKee Lumber Company (Tr. 179-181). The amount of this claim is $494.64.

Exhibit 56. Claim of the Montana Coal & Iron Company (Tr. 185-186). The amount of this claim is $162.92.

Exhibit 58. Claim of Standard Paint Company (Tr. 194-196). The amount of this claim is $177.93.

These claims are for merchandise purchased subsequent to the giving of the chattel mortgage. They amount to $1885.67. Two-fifths of the total claims filed and allowed, outside of the claim of the Bank and when we consider that the total deposit in the Bank as shown by Mr. Moe (Tr. 281) only amounted to $8,700.00, this is quite a large item, especially when we take into consideration,

the value of his merchandise was estimated by Russell to be of the value of $6,000.00 at the time of the giving of the chattel mortgage.

CREDITORS OF RUSSELL AT THE TIME OF THE GIVING OF THE CHATTEL MORTGAGE

The following claims will show, who were creditors of Russell at the time of the giving of the chattel mortgage, outside of the Bank and F. E. Russell, the father of the Bankrupt.

Exhibit No. 47, claim of Eureka Lumber Company (Tr. 144-146-178. The amount owing at the time of giving the chattel mortgage was $681.60. The amount due at the time of the filing of the petition is $342.43. (Tr. 276).

Exhibit 49. Claim of the Eclipse Paint and Manufacturing Co. (Tr. 147 and 182.) The amount of this claim is $141.05; nothing paid on the claim since execution of mortgage.

Exhibit No. 46. Claim of Atlas Oil Company (Tr. 150-151-154). The amount of this claim is $154.43. Seventy-five dollars paid on account since execution of mortgage.

Exhibit No. 51. Claim of the Northwestern Lumber & Shingle Company (Tr. 151 and 152). The amount of this claim is $575.00; nothing paid since execution of mortgage.

Exhibit No. 52. Claim of McCormick Lumber Company (Tr. 152-153-166). The amount of this claim is $750.50. Sixty-three ($63) Dollars paid subsequent to execution of mortgage.

Exhibit No. 53. Central Door & Lumber Company (Tr. 169-170). The amount of this claim is $528 94; nothing paid subsequent to the execution of mortgage.

Exhibit No. 57. Pacific Lumber Agency (Tr. 190). The amount of this claim is $460.14; nothing paid after execution of mortgage.

Exhibit No. 59. Lndstrom Handforth Lumber Company (Tr. 200). The amount of this claim is $151.35; One Hundred and Fifty Dollars paid subsequent to giving the mortgage.

The amount of these claims is $3,103.84, for merchandise purchased prior to the giving of the chattel mortgage and owing at the time the chattel mortgage was given and only $288.00 paid out of the proceeds of sales and it is claimed they shared in all payments made and are estopped.

MONEYS RECEIVED BY RUSSELL, FROM THE SALES OF MERCHANDISE, WERE CONVERTED BY HIM TO HIS OWN USE, WITH THE KNOWLEDGE AND CONSENT OF THE BANK.

We do not mean by this to be understood as claiming that Russell actually took this money and spent it himself but we will show that the proceeds of the sales of merchandise were used to pay indebtedness existing prior to the giving of the chattel mortgage and therefore was a conversion. This money should have been applied on the mortgage indebtedness.

Counsel at page 19 of their brief refer to this question, they say:

> "No Court has ever before said that the payment of just debts is a fraud upon anyone."

This is not the question. When Mr. Russell mortgaged to the Bank, his agreement with them and with his creditors was that he would first pay the Bank out of the proceeds of the mortgaged property and that is what he was obliged to do. He had no right with the consent of

the Bank to pay it to creditors other than the Bank, in any manner that he pleased.

We desire to briefly draw the attention of the Court to these payments of money, as shown by the checks, issued by Russell and introduced in evidence.

These checks were all paid by the Scandinavian American Bank, out of the account kept by Russell.

Exhibit No. 1. Check paid to J. B. Selters, an attorney, for $262.00 (Tr. 95). The check shows from a notation on it, that it was for the account of a note due The Western Lumber Company, an indebtedness existing before the mortgage was given.

Exhibit No. 2. A loan made to C. W. Russell, a cousin of the Bankrupt, for $60.00 (Tr. 95-97).

Exhibit No. 3. A check given to the Scandinavian American Bank for $124.71(Tr. 97-98). The evidence shows that this was for interest owing the Bank prior to the giving of the chattel mortgage. The evidence also shows that when this check was given, the Bank permitted an over-draft, which was later made good.

Exhibit No. 4. A check for $50.00 given John Ellingson for Life Insurance. (Tr. 99).

Exhibit No. 5. A check for $100.00 in favor of the Montana Sash & Door Company. This was paid on open account (Tr. 101).

Exhibit No. 6 A check for $100.00, payable to Fletcher & Evans on the account of Lindstrom Handforth Company (Tr. 102 and 103). Fletcher & Evans were attorneys and a notation on the check before it was cashed by the Bank says:—"Lindstrom Handforth bill, this check was for merchandise purchased prior to the giving of the chattel mortgage."

Exhibit No. 7. A check for $60.00 to C. W. Russell, a cousin of the debtor (Tr. 103-4).

Exhibit No. 8. A check for $50.00 to the Bellingham National Bank (Tr. 104-5). A payment on note for lumber.

Exhibit No. 9. (Tr. 106). A check for $10.00 in favor of C. W. Allen, Sec. An endorsement on notation on the check shows it was for "Chautauqua" and was a contribution.

Exhibit No. 10. A check for $50.00 to J. B. Selters (Tr. 106-7). Mr. Selters was an attorney at Big Timber and this was on the account of the Northwestern Lumber Company for merchandise purchased prior to the giving of the chattel mortgage.

Exhibit No. 11. A check for $50.00, in favor of the Eureka Lumber Company (Tr. 107-8). A notation on the check shows that it was on open account. Actual notice to the Bank, that he was not paying cash for what he was purchasing.

Exhibit No. 12. A check for $50.00 to J. B. Selters, on account of the note of the Northwestern Lumber Company. Mr. Selters is an attorney at Big Timber, known to the Bank. (Tr. 108-9).

Exhibit No. 13. Check for $58.55, given to the Eureka Lumber Company, (Tr. 109). A notation shows that it was on account.

Exhibit No. 14 and 15. Each check is for $25.00, given to J. B. Selters on the account of the Western Lumber Company, for merchandise purchased prior to the giving of the chattel mortgage. (Tr. 110-112).

Exhibit No. 16. A check for $50.00, given to the Bellingham National Bank. At the bottom, the check shows that it was a payment, on note to Northwestern

Lumber and Shingle Company (Tr. 112-113), for merchandise purchased prior to the giving of the chattel mortgage.

Exhibit No. 17. A check for $50.00 payable to Fletcher and Evans Co. (Tr. 113-114). A notation on the check, "on Lindstrom Handforth account."

Exhibit No. 18. A check to Joe Meister $25.00. A notation on the check shows that it was final payment on note given for mare. Indebtedness existed at the time of the giving of the chattel mortgage. (Tr. 114-115).

Ehibits 19 and 20. Checks for $25.00 and $16.00, given to J. B. Selters, an attorney. On a note to the Western Lumber Company. (Tr. 115-117).

Exhibit No. 21. A check given to H. Uttermohl (Tr. 117-118). A notation on the check shows that it was one half payment and interest on some real property purchased.

Exhibit No. 22. A check for $32.50, given to the McCormick Lumber Company (Tr. 118-119). A notation on the check shows that it was on account.

Exhibit No. 23. A check given to the Bellingham National Bank for $25.00 (Tr. 120 and 121). A notation on the check shows it is a payment "On note of Northwestern Lumber Company."

Exhibit No. 24. A check in favor of H. Uttermohl for $50.00 (Tr. 121). A notation on the check shows it is a final payment for real estate purchased.

Exhibit No. 25. A check for $52.49, paid to the Scandinavian American Bank (Tr. 122-123). This is a payment to the Bank for a loan made subsequent to the giving of the chattel mortgage, evidenced by a note for which a chattel mortgage on an automobile was given as security.

The Bank itself was not averse to funds being diverted from their regular course.

Exhibit No. 26. A check for $40.00 paid to L. Powell. Notation on the check, "To apply on note." (Tr. 124).

Exhibit No. 27. A check for $20.00 drawn in favor of Frank Lamp, an attorney, on an account held by Mr. Lamp for collection. (Tr. 125).

Exhibit No. 2.8 A check for $50.00, drawn in favor of J. B. Selters, attorney. A notation on the check, "On account of Eureka Lumber Company." (Tr. 126).

Exhibit No. 29. A check for F. E. Lamp, $20.00 (Tr. 126-127), an attorney.

Exhibit No. 30. A check for $32.10, drawn in favor of the Row James Glass Co. A notation on the check shows, "Balance in full, for plate glass"(Tr. 127). This was for merchandise purchased after the giving of the chattel mortgage but it shows that Russell was purchasing on credit.

Exhibit No. 31. A check given to the Oliver Typewriter Company for $15.00 (Tr. 129). A notation on the check shows balance in full for machine.

Exhibit No. 32. A check given to A. W. Miles Lumber Company $39.85. Tr. 131-2). A notation on the check shows "Part payment on cement."

Exhibit No. 33. A check payable to the Bankrupt himself for $65.00. (Tr. 131).

Exhibit No. 34. A check payable to the A. W. Miles Lumber Company for $25.00. A notation on the check, "On account." (Tr. 132).

Exhibit No. 35. A check payable to A. W. Miles Company for $25.00 (Tr. 133). A notation on the check, "Balance on account in full."

Exhibit No. 36. A check payable to J. B. Selters,

an attorney, (Tr. 133 and 134). A notation on the check, "On Eureka account."

Exhibits 39 and 45 (Tr. 136 to 142) show checks payable to the City Meat Market. These were all for the living expenses of the Bankrupt. But this methor of paying them was a violation of the provisions of the chattel mortgage.

The amount as shown by these checks altogether is a little over $1,800.00. Money diverted, the proceeds of the sale of merchandise from the course intended to be pursued, under the provisions of the chattel mortgage, used solely for the purpose of keeping the business going at all costs.

It will not do to say that the Bank did not know, for all of these checks were paid through the Bank and the notations plainly told the Bank what Russell was doing and the course he was pursuing in his business.

Had the proceeds of sales been deposited daily in the Bank to the credit of the Bank, this could not have happened. It will not do to say that Russell might have made these payments by keeping the money in his possession and then the Baik would have known nothing about it, for he pursued a course that gave the Bank knowledge.

Had the Bank insisted on this monthly accounting all these things would have been brought to light and prevented.

The Montana Supreme Court speaking of the provision allowing the mortgagee to retain his living expenses says:—Page 443 Montana Reports, Noyes vs. Ross, supra.

> "All such agreements, however, whether in parol or included in the mortgage itself, should be closely scrutinized, for they force the transaction involved close to the line where the law will say that parties have adopted a means whereby creditors are hindered

and delayed; yet notwithstanding all this, such mortgages are not necessarily of such a character that the law will conclusively imply fraud, if none actually exists, but will leave the question of good faith to be tried as one of fact."

The Court says on page 448:—

"The presence or absence of vice in this agreement is tested by the inquiry whether the sales were to be made in the interest of the mortgagor, and the proceeds controlled by him, so that they might not be applied upon the mortgage, or whether they were to be made in strict and faithful execution of a real trust, so that every decrease of the security should work a corresponding reduction of the debt."

The case of Rocheleau v. Boyle, decided by the Supreme Court of our own state and reported in 11 Mont. page 451, 28 Pac. 875, is an instructive case on the subject of fraud in chattel mortgages. In this case a mortgage was given covering a stock of merchandise among other things, without any provision permitting the mortgagor to sell the merchandise, this he did however with the constructive and actual knowledge of the mortgagee. the mortgage being made in good faith, it was held valid as to everything except the merchandise sold, the proceeds of which were diverted.

The Supreme Court says on page 459:—

"One sold and the other bought of the goods in question; one continued to sell and the other was fully cognizant of the selling and the carrying on of the business openly as before the mortgage was executed, and without objection or remonstrance from the mortgagee; and this conduct appears to have been by their own violation, because there is no showing that either acted under duress, delusion or insanity."

The same thing was done in the present case, sales made without any accounting and the money placed in

the bank of the mortgagee to the credit of the mortgagor in violation of the provisions of the mortgage, and checked out by Russell.

Again on Page 465, the Court says:—

> "What was meant was, that such an instrument should not be used to enable the mortgagor to continue in business as theretofore, with full control of the property and business, and appropriating to himself the benefits thereof, and all the while holding the instrument as a shield against the attacks of unsecured creditors."

On page 469, the Court says:—

> "Now, if a mortgage of goods be made as provided by statute leaving possession with the mortgagor, and it be understood, agreed or knowingly permitted (for if it is knowingly permitted, it is understood and agreed) to the mortgagor to place the mortgaged goods on sale, not subject to the mortgage, to be sold, carried away or consumed, and the proceeds used without reference to the mortgage, this arrangement annuls every vital element of the mortgage so far as concerns the goods to which such arrangement or permission extends. The mortgage under such circumstances, becomes a mere sham, a mere appearance, a delusion, asserting in form what is not in fact, as admitted by the conduct of the parties. The possession does not remain nor does the property remain. It is shifted over to those who will come and buy and is carried away without respect to the mortgage, and the proceeds devoted to purposes other than to answering for the debt mentioned in the mortgage. The parties to such an arrangement have departed from the observance of a statutory requirement as to the property to which such arrangement or permission applies, and we think there ought to be no hesitation in holding the mortgage void as to property so dealt with; or in other words, that such property is put out from under such mortgage by the conduct of the parties in relation to it.

This language is again repeated word for word in the case of Stevans v. Curran, 28 Mont. page 366; 72 Pac. 753.

In Heilbroner v. Lloyd, 17 Mont. page 299, on page 307, the court says in an opinion by Justice Hunt, now a member of this Court:—

"Whether or not the mortgae was made in good faith, and whether or not it was agreed between the mortgagor and the mortgagee that the mortgagor might sell the goods at retail and apply the proceeds to liquidate the debt, and such agreement was a condition entered into in good faith between the parties, was likewise a question of fact."

It is contended by counsel that because Russell testified that he had no money with which to pay the Bank, to apply on the mortgage debt, this is conclusive. We do not think so, for the only way this could be determined, is by an accounting.

However, from the testimony of Mr. Moe, the cashier of the Bank, who produced the ledger account of Russell with the Bank which was in his hands, it appears that there was daily a balance to the credit of Russell, (Tr. 241). Mr. Moe was examined as to the balance on hand between the first and the 11th days of each month and a reference to the transcript (pages 241 to 249) will show what these balances were and at times the daily balance was almost $500.00.

Had this account been kept in the name of the Bank or rather this money deposited to the credit of the Bank, it could not have been withdrawn at the will and pleasure of Russell. This situation however, was certainly notice to the Bank of the manner in which the business was being handled, it was put on inquiry, not only to protect itself but other creditors.

We contend that this showing is to the effect that there was money on hand which could have been applied

on the note secured by the mortgage. Russell is not to be the sole judge of this matter.

While on this question of the Bank account, we draw attention to the fact that on December 1st there was an overdraft of $78.35. (Tr. 245) Mr. Moe states that this was not an additional loan on credit. The fact remains however it was notice to the Bank that Russell was not doing a cash business and it certainly is an indication that the Bank was permitting Russell to handle things to suit himself.

There were overdrafts on January 14th, 1916, and September 28, 1915 (Tr. 248). Mr. Moe testified (Tr. 248) that at all periods between June 29, 1915, and February 11, 1916, with these three exceptions, there was always a balance to the credit of Russell, at the close of each day's business, and inspection of the Exhibit, will show how much.

Mr. Ellingson, the trustee (Tr. 247) states that all the money he has on hand is $2,600 and that this includes the proceeds from the sale of the merchandise claimed by the bank and this also includes $350.00, part of the proceeds of the sale of the real property, which is being held to cover a proportion of the share of the expenses of administration. So it will be seen that there is not sufficient assets even to pay claims filed and allowed, if the chattel mortgage is set aside.

It is admitted (Tr. 276 and 277) what claims have been filed with the referee. They total $4,989.91. This is independent of the claim of the Bank, Aulutman Tailor Manufacturing Company and any claims that may be hereafter filed. In this summary the claim of Blodel Donovan Lumber Company should be $621.56 and not $64.56 (Tr. 151).

Mr. Ellingson stated after examining the accounts receivable of Russell, the amount of the same being stipulated, that there was $1611.72, unpaid, sold on a credit longer than thirty days. (Tr. 277-278). These are the accounts, proceeds of the sale of merchandise, sold for the account of the bank; if the chattel mortgage be a valid lien. If it is held void, we contend of course that the bank will only share equally with the other creditors in all assets.

Some reference is made by counsel to the fact that Russell received from his ranch, and what is known as the Springdale business something like $600.00 which was paid into the bank and checked out by Russell. The Springdale business was a branch of his Big Timber business. Everything that went to Springdale was either sent from Big Timber or else was paid for by Russell at Big Timber, or is a liability of his Big Timber business. In other words the Springdale business was not a separate and distinct business but was covered by the chattel mortgage (Tr. 218-9-331-333).

The only money that he received from the ranch was $200.00 to $250.00 (Tr. 206). This could make very little difference in the situation.

All the merchandise bought by Russell subsequent to the giving of the chattel mortgage was received by him in his Lumber Yards, used in his business and what not sold by him passed into the hands of the trustee (Tr. 283).

The argument of counsel on page 20 of the brief is that because the Bank allowed the mortgagor to pay some of his creditors, contrary to the provisions of the chattel mortgage, instead of the Bank playing "Whole Hog", no one has a right to complain, even if the provisions of the chattel mortgage were violated. Under the authorities,

the Bank had no right to do this for the chattel mortgage placed the property beyond the reach of creditors, until the bank was paid. The Bank had no right to let Russell be generous to some creditors to the exclusion of others.

On page 23 of the brief the Bank, through its Counsel says: "The objectors who come into Court here and complain of the Bank's loan are the very creditors who have shared in the fruits of the loan, made by the Bank under the mortgagee."

The claims filed do not show that the creditors filing them, received any portion of the money for which the principal note was given and as a matter of fact the evidence does not disclose what the mortgage indebtedness was for, and even if some of these creditors did receive a part of the money evidenced by the principal note, that is no reason why subsequent to the giving of that note and the security, the provisions of the mortgage should not be complied with.

Counsel further say on page 23 of their brief,

> "If the bank in good faith has advanced money to Russell to keep his business going for more than eight months, these creditors have thrown him into bankruptcy and by so doing ended their chances of receiving payment in full. Yet they now ask the Bank, 'to hold the sack.' They have taken all of the proceeds of the business, that they could reach with one hand; with the other they now ask a court of equity and good conscieoce to give them what is rightfully the bank's security. They make no offer of restitution; give no explanation for their own participation in the breaches of the mortgage condition, which they allege. If ever there was a case where 'Clean Hands' are demanded in a court of equity, this contest is one."

This argument to say the least is amusing. At the time the mortgage was given to secure indebtedness, then

due to the Bank, there were other creditors to a large amount, and it would look as if the Bank at that time intended to let the other creditors "Hold the Sack."

Counsel claim that the creditors or the trustee acting for them has taken all the proceeds of the business they could reach and now ask a Court of Equity to give them what is rightfully the Bank's security.

The trustee only asks that these proceeds be applied so that all creditors would participate and that the Bank will not take everything.

This brief has been extended longer than it ought to have been but we feel that all of the allegations of the objections have been sustained and the order of the referee, affirmed by the District Judge, under the well known rule should be affirmed.

WHERE THE TESTIMONY IS CONFLICTING, THE FACTS WILL NOT BE INQUIRED INTO.

"Where the testimony is conflicting and the findings of fact of the Referee and the District Judge are the same, the facts will not be inquired into by an appellate court, unless there is plain error."

In re. Door (Ninth Circuit) 28 Am. B. R. 505 and cases cited.

"The findings of fact of a referee, affirmed by the District Court, will not be disturbed on appeal where supported by substantial evidence."

Wilson vs. Continental Building & Loan Association (Ninth Circuit) 37 Am. B. R. 444.

"Where the referee and the District Court have considered conflicting evidence and made a finding or decree thereon, that finding is presumptively right, and it should not be reversed unless it clearly appears that they have fallen into some error of law or have made some serious mistake of fact."

First National Bank of Philadelphia vs. Abbott (Eighth Circuit) Am. B. R. 436.

"But the rule is well established that where two courts have concurred in findings of facts in a suit in equity, this court will accept those findings, unless clear error is shown."

Page vs. Rogers (Sup. Ct. U. S.) 21 Am. B. R. 498.

In re Sweeney (Sixth Circuit) Volume 21, Am. B. R. 867 Canner vs. Webster Tapper Company (First Circuit) 21 Am. B. R. 872.

"A referee's findings of fact affirmed by the District Judge, will not be disturbed unless clearly erroneous."

In re. Noyes Bros. (First Circuit) 11 Am. B. R. 506.

Respectfully submitted,

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Attorney for Trustee and Respondent.

Service of the within brief and a copy acknowledged this.....day of October, A. D. 1917.

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Attorneys for Petitioner.